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ELEVENTH MEETING OF THE PARTIES TO
THE MONTREAL PROTOCOL ON
SUBSTANCES THAT DEplete
THE OZONE LAYER
Beijing, 29 November—3 December 1999

**REPORT OF THE TREASURER OF THE MULTILATERAL FUND ON THE USE OF A
FIXED CURRENCY RATE MECHANISM FOR THE REPLENISHMENT OF THE
MULTILATERAL FUND**

EXECUTIVE SUMMARY

1. The present report has been prepared in response to the decision of the Open-Ended Working Group of the Parties to the Montreal Protocol on Substances that Deplete the Ozone Layer, at its nineteenth meeting, held in Geneva, 15—18 June 1999, that the Treasurer should prepare a report for the technical segment of the Eleventh Meeting of the Parties that applied the mock-study of the fixed currency rate mechanism to the actual replenishment period 1994—1996.
2. The modified mock study was based on the same parameters as those used in the original study for a fictitious replenishment period 1996—1998. The only exception is the threshold used to determine the Parties which are eligible to use the fixed currency exchange rate mechanism, which has been adjusted from 13 to 10 per cent, at the request of the Open-Ended Working Group at its nineteenth meeting.
3. The findings of the modified mock study indicated that should the fixed currency rate mechanism had been used for the replenishment period 1994—1996, the total gain to the Multilateral Fund would have been \$14,050,000, or 3.19 per cent of the agreed contributions of \$440.4 million. This conclusion differs considerably from the conclusion of the original mock study, which indicated that for the fictitious replenishment period of 1996-1998 there would have been a loss of \$43 million, or 9 per cent of the total assumed agreed contribution of \$474 million.

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INTRODUCTION

4. The Tenth Meeting of the Parties to the Montreal Protocol, by its decision X/32, requested the Treasurer to prepare in time for the nineteenth meeting of the Open-Ended Working Group a discussion paper which described how a mechanism using fixed currency exchange rates could be implemented for the replenishment of the Multilateral Fund.
5. In response to that decision, the Treasurer prepared and submitted to the Open-Ended Working Group at its nineteenth meeting a discussion paper on the use of a fixed currency rate mechanism for the replenishment of the Fund, contained in document UNEP.OzL.Pro/WG.1/19/6, describing the results of the mock study for a fictitious replenishment period 1996-1998. In this study, a number of parameters were used in the analysis and these included, first, establishment of the 13 per cent threshold for eligibility to use the mechanism based on three years historical rates; second, the fixing of the rates to use during the fictitious replenishment period, using the average currency rates of the six months preceding the replenishment; and, third, the assumption that, during the fictitious replenishment period 1996-1998, the Parties paid their annual contributions to the Multilateral Fund in two equal instalments in June and December of the applicable year.
6. The study's findings indicated that, should a fixed currency rate mechanism have been applied to the Multilateral Fund for the fictitious replenishment period 1996-1998, there would have been a loss to the Fund of \$43 million, or 9 per cent of the total assumed agreed contribution of \$474 million.
7. At its nineteenth meeting, the Open-Ended Working Group reviewed the study and, on the recommendation of the contact group, the Working Group decided:
 - (a) To request the Treasurer to prepare a report for the technical segment of the Eleventh Meeting of the Parties that applied the mock-study analysis to the replenishment period 1994-1996. The purpose of this study would be to provide the Parties with a greater period of reference in order to assess the effects on the Fund;
 - (b) That the exchange-rate depreciation criterion described in paragraph 38 of the report of the Treasurer (UNEP/OzL.Pro/WG.1/19/6) should be replaced by a 10 per cent inflation rate, in order to bring the proposal more in line with the criteria used in other international financial mechanisms;
 - (c) That the Treasurer should consult with donor countries on the question of whether due dates for payments of contributions could be fixed, should collaborate with the Chief Officer of the Multilateral Fund Secretariat in order to determine how fixed payments dates during the year might affect business planning by the Fund, and should report thereon to the technical segment of the Eleventh Meeting of the Parties; and
 - (d) That the information requested above should be further considered at the technical segment of the Eleventh Meeting of the Parties, which would decide whether or not to forward a draft decision on the subject to the ministerial segment of the Meeting.
8. The present report has been prepared in response to that decision and should be read in conjunction with the original discussion paper of the Treasurer (document UNEP/OzL.Pro/WG.1/19/6), which is reproduced in annex IV to the present report, for

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information purposes.

I. MOCK STUDY FOR THE 1994—1996 REPLENISHMENT PERIOD

9. Pursuant to paragraphs (a) and (b) of the decision of the nineteenth meeting of the Open-Ended Working Group, the Treasurer of the Multilateral Fund conducted an additional study of the fixed currency rate mechanism, applying it to the 1994—1996 actual replenishment period and using the same assumptions as those ones used in the original study, except for the eligibility criteria of 10 per cent rather than the 13 per cent used earlier.

10. The findings of the study are that, if the fixed currency rate mechanism had been used for the replenishment period 1994-1996, there would have been a gain in the income of the Multilateral Fund of \$14.05 million, or 3.19 per cent of the total agreed contribution of \$440.4 million, and 3.62 per cent of the contributions of \$388.2 million which had been paid in national currencies. Annual gains would have been as follows: 1994—\$1,142,000, or 0.78 per cent; 1995—\$9,882,000 or 6.73 per cent; and 1996—\$3,029,000, or 2.06 per cent. With respect to the national currencies used, these figures correspond to a weighted average appreciation against the United States dollar of some 9.6 per cent over the total period, averaging about 3.1 per cent annually. Detailed information on the effect of the fixed currency rates mechanism for individual countries is shown in annex I to the present report.

11. It should be noted that the original study showed a loss of \$7.5 million for 1996, while the present study is showing a gain of \$3 million during the same year. This apparent discrepancy is explained by the different reference periods used for fixing the exchange rates in the two studies. Whereas in the original study the basis of fixing the currency rates to be used during the year was the average of the period May–October 1995, in the present study, the period used was May–October 1993.

12. The findings of the present study confirm to some degree the statement in paragraph 25 of the original study that, although a loss was experienced during the fictitious replenishment period 1996-1998, it could well be expected that the reverse might also occur in the future. At the same time, the often expressed view that, in the long term, currency fluctuations will tend to cancel each other out cannot be considered very valid for the Multilateral Fund, which has a finite lifetime, with no more than perhaps three additional replenishment periods expected.

13. The agreed contributions from the 11 countries using the Euro amounted to approximately 30.32 per cent of originally agreed contributions, or about \$133,550,000 for the actual replenishment period used in the present study. As a result of exchange rate gains, these contributions increased by about \$6,170,000—or by about 4.62 per cent—from the agreed total amount. This gain of \$6,170,000 constituted about 43.93 per cent of the total exchange rate gain to the Multilateral Fund of \$14,053,000 million.

14. The corresponding total exchange appreciation against the United States dollar for the 11 Euro-using Parties for the period ending in December 1996 varied between 6.52 per cent and 20.83 per cent, with 10 Parties out of the 11 experiencing appreciation against the United States dollar of 10 per cent or more over the total period. The weighted average gain was about 12 per cent, corresponding to an annual average appreciation of about 4 per cent.

15. The agreed contribution of Japan during the 1994—1996 replenishment period amounted to \$65,152,000 for the actual replenishment period of 1994—1996, about 14.79 per

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cent of all agreed contributions. During the replenishment period of 1994—1996, when compared to the rate at which it was fixed for the purposes of the mechanism, the Japanese yen first remained relatively stable with inclinations to appreciate and then appreciated significantly by about 10 per cent for a while, before depreciating towards the end of the year 1996. The gains of \$4,462,000 recorded by Japan during the replenishment period mostly occurred during 1995, when a \$3,825,000 gain was recorded. In 1994, a gain of \$1,226,000 was recorded, as the currency was appreciating gradually, and, in 1996, there was a loss of \$589,000 as the currency depreciated.

II. FIXING DUE DATES FOR PAYMENTS

16. As stated in paragraph 171 (c) of the report of the nineteenth meeting of the Open-Ended Working Group of the Montreal Protocol, the Treasurer was requested to consult with donor countries on the question of whether due dates for payments of contributions could be fixed. As stated in paragraph 43 of the discussion paper (UNEP/OzL.Pro/WG.1/19/6), the Treasurer had suggested that a decision be considered to fix 31 March and 31 October of each year for payment of contributions. The Treasurer has requested all donor countries to indicate whether dates for payments of contributions could be fixed and how this could affect their pattern of payments. As of the time of preparation of the present report, the replies from the donors have not yet been received¹.

17. At the same meeting, the Open-Ended Working Group requested the Treasurer to collaborate with the Chief Officer of the Multilateral Fund Secretariat in order to determine how fixed payment dates during the year might affect business planning by the Fund. Consultations took place between the Treasurer and the Fund Secretariat.

18. The Chief Officer provided the following information:

(a) Resource allocation for the business planning of the Multilateral Fund is based on the amount of contributions that is expected to be paid by the Parties who have historically paid their contributions in full. For the 1997—1999 triennium, allocation of resources to the three-year business plan was based on \$512 million, instead of a budget of \$540 million approved by the Eighth Meeting of the Parties;

(b) The Executive Committee distributes the resources among the implementing agencies by fixing an annual amount for each year of the triennium. The implementing agencies have agreed among themselves on their fixed shares of investment projects. Based on the value of those shares, the implementing agencies develop their annual business plans apportioned among Article 5 countries, sectors and funding windows determined by the Executive Committee based on the needs for the phase-out of ozone-depleting substances;

(c) Any uncertainty in resource availability will upset this balance inherent in the business planning of the Multilateral Fund and would have a negative impact on the implementation of projects to phase out ozone-depleting substances;

¹ Information received from donors prior to the Eleventh Meeting of the Parties to the Montreal Protocol will be presented to the technical segment of the Meeting as an addendum to the present report.

(d) A review of the trend in payment of contributions to the Multilateral Fund over the last eight years (1992-1999) shows that, on average, contributions received in a given year range from 40 to 60 per cent of the agreed pledges for that year. This trend clearly makes the efficient implementation of the business planning extremely difficult, since a considerable proportion of projects included in a given year's business plan will only be funded in the following year. Because of this, the Executive Committee approves funding for the remainder of projects in the year's business plan at the first meeting of the following year, when substantial portions of previous years' contributions will have been paid;

(e) To illustrate this, the following table shows the pledged contributions and the amount of contributions received against the year's pledges in time for the Executive Committee's three meetings of the year, from 1997 to the Committee's meeting in July 1999;

	1997 (US\$)	Per cent	1998 (US\$)	Per cent	1999 (US\$)	Per cent
Pledged contributions	157,545,040	100%	157,545,040	100%	157,545,040	100%
March meeting	380,671	<1%	1,191,165	<1%	7,553,267	5%
July meeting	11,616,691*	7%	46,822,673	30%	38,545,533	24%
December meeting	70,016,268	45%	64,342,480	41%	N/A	N/A

* The second meeting of 1997 was held in May.

Source: Executive Committee meeting reports.

(f) As shown in the table, 1—5 per cent of the year's contributions is received into the Fund by the time the Committee holds its first meeting in March. By July, 7—30 per cent of the year's contributions is received;

(g) Fixing the dates of payment as suggested by the Treasurer would indeed impart more certainty to the amount of resources that will actually be available for commitment by the Executive Committee during the year of the business plan.

19. In the light of the above considerations, the following might be concluded:

(a) There is a great benefit in maintaining the current system for contribution, payment and management because it provides for the predictability of the overall level of available resources necessary for Multilateral Fund business planning. Any unpredicted decrease in the amount of contributions will introduce uncertainty in the business planning of the Multilateral Fund;

(b) On an annual basis, and especially considering the current operating modalities of the Executive Committee where project approvals are effected at each of its three meetings during a business planning year, fixed payment dates will avert the current uneven flow of contributions during the year and enable the Multilateral Fund's annual business plan to be fully funded in the year of the plan.

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III. MONITORING OF EXCHANGE RATES

20. The Tenth Meeting of the Parties to the Montreal Protocol, in paragraph 2 of its decision X/32, requested the Treasurer of the Multilateral Fund to monitor exchange rates of donor country currencies, including the Euro, between 1 March 1999 and 30 September 1999, and to submit, in time for the Eleventh Meeting of the Parties to the Montreal Protocol, a table showing the average rates for each donor country currency with the United States dollar and Special drawing rights (SDRs) for this period.

21. The Treasurer of the Multilateral Fund has used the United Nations monthly exchange rates in compiling this table, which is provided as annex III to the present report.

Annex IV

REPORT OF THE TREASURER OF THE MULTILATERAL FUND ON THE USE OF FIXED CURRENCY RATE MECHANISM FOR THE REPLENISHMENT OF THE MULTILATERAL FUND ²

EXECUTIVE SUMMARY

1. The present document has been prepared in response to the request of the Tenth Meeting of the Parties that the Treasurer of the Multilateral Fund prepare a discussion paper on the implementation of a fixed currency exchange rate mechanism for the next replenishment of the Fund.
2. In preparing the discussion paper, the Treasurer reviewed the mechanism applied to the replenishment of the Global Environment Facility (GEF), where a fixed exchange rate mechanism is used. The fundamental difference between the contribution mechanisms of GEF and of the Multilateral Fund is that, while both approve projects and programmes in United States dollars, the agreed contributions to GEF are denominated in special drawing rights (SDRs) or, more significantly, in the national currency of the contributing Government in question. Accordingly, the exchange rate risk against the United States dollar is borne by the GEF Trust Fund, not by the contributing Parties, as is the case for the Multilateral Fund.
3. A mock desk study was conducted for a fictitious Fund replenishment period of 1996-1998, to evaluate the possible impact of a GEF-like fixed exchange rate mechanism for the Multilateral Fund. This study indicated that the total loss to the Fund over the three-year period would have been \$43 million, or 9 per cent of the total assumed agreed contribution of \$474 million. Almost all of this exchange rate loss would have been due to the depreciation of the yen (\$22 million) and of the currencies of the eleven countries now using the Euro (\$18 million). It may be assumed, however, that the trend of steady depreciation of most major currencies against the United States dollar will not continue indefinitely and that the reverse might also occur, resulting instead in exchange gains for the Fund in the future.
4. The latter part of the present document describes a possible procedure to be adopted by the Multilateral Fund along the lines of a simplified GEF model, whereby contributing countries could be given the option of either agreeing to denominate and pay their contributions in United States dollars, or to denominate and pay their contributions using their national currency. Criteria for determining which Parties should continue to pay their contributions in United States dollars are also suggested, as well as some measures to contain the currency exchange rate risk to the Multilateral Fund within reasonable limits. These procedures are outlined in paragraphs 31-40 below.

² As contained in document UNEP/OzL.Pro/Wg.1/19/6 of 30 April 1999.

INTRODUCTION

5. The present report is submitted in response to decision X/32 of the Tenth Meeting of the Parties, by which the Parties requested the Treasurer of the Multilateral Fund to prepare a discussion paper on the possible implementation of a fixed currency exchange rate mechanism for the next replenishment of the Fund. The text of decision X/32, entitled "Proposal to study a fixed currency exchange rate mechanism for the replenishment of the Multilateral Fund", is reproduced below in full for ease of reference:

"Noting that some donor countries make payments to the Multilateral Fund in their national currencies, and that minor discrepancies often arise from the different exchange rates used to issue and encash their payments,

"Further noting that some financial procedures have been utilized by other multilateral funding mechanisms to simplify the administration of these contributions and limit these discrepancies,

"1. To request the Treasurer of the Multilateral Fund to prepare, in consultation with relevant institutions and Parties and in time for the nineteenth meeting of the Open-ended Working Group, a discussion paper which describes how a mechanism using fixed currency exchange rates could be implemented for the replenishment of the Multilateral Fund for the triennium 2000-2002. The paper should examine the administrative framework, the potential impact and any risks for the operation of the Fund that are associated with the adoption of such a mechanism. The paper should also include criteria for determining if a particular currency's fluctuations had been of such a magnitude that a fixed exchange rate mechanism would not be practical, in which case that country would continue to make its commitments and payments in United States dollars;

"2. To request the Treasurer of the Multilateral Fund to monitor exchange rates of donor country currencies, including the Euro, between 1 March 1999 and 30 September 1999, and to submit in time for the Eleventh Meeting of the Parties a table showing the average exchange rate for each donor country currency with the United States dollar and Special Drawing Rights (SDRs) for this period".

I. BACKGROUND

6. As implied in the preambular paragraphs of decision X/32, a number of Parties contributing to the Multilateral Fund for the Implementation of the Montreal Protocol have expressed some concern *vis-à-vis* the current practice for determining the contribution amounts due to the Fund and on the modalities for the acceptance of payments of contributions to the Fund.
7. Contributions to the Fund, denominated in United States dollars, are agreed in advance for a three-year replenishment period, through a decision of the Parties taken at the meeting of the Parties held in the year preceding the first year of that triennium. Some countries experience a modicum of difficulty in programming United States dollar-denominated amounts three years in advance, instead of amounts denominated in their local currencies. This is one of the basic underlying reasons for the discussion on a possible fixed exchange rate mechanism.
8. The Fund accepts contributions paid either in cash or in the form of promissory notes. Payment in cash is accepted in United States dollar or in any convertible currency; in the latter case the amount is acknowledged and receipted at its actual United States dollars equivalent after conversion and deposit into the United States dollar bank account of the Fund. When payments of contributions are made in promissory notes, these may be denominated either in United States dollars or the convertible national currency of the contributing Government. Payments in non-United States dollar-denominated notes are acknowledged at their United States dollar equivalent at the time of deposit of the note. According to the decisions of the Parties and of the Executive Committee of the Fund, however, contributions to the Fund are agreed in United States dollars, and therefore the exchange rate risk for non-United States dollar-denominated promissory note contributions is borne by the contributing Government, not by the Fund.
9. The ultimate United States dollar value of contributions made to the Fund in non-United States dollar-denominated promissory notes will be known only after full encashment of such notes, which may occur up to three years after deposit. Consequently, Parties contributing through such notes may, in some cases be, obliged to pay significant additional contributions years later owing to the differences in exchange rates used at issue and encashment of notes. Conversely, any exchange gain realized in the process would be credited to the contributing Party, not to the Fund.
10. It may be noted in this connection that promissory notes issued as contributions to the Fund are non-interest bearing, and thus the contributing Party gains the interest income which would otherwise benefit the Fund in the case of cash contributions. This is of course true both for contributing Parties using non-United States dollar-denominated notes as well as for those using promissory notes denominated in United States dollars.
11. As a result of the budgetary difficulties caused by the modalities described above, both for cash and promissory note contributions, some contributing Parties would prefer the use of a fixed exchange rate mechanism for contributions to the Fund, making possible the accurate and final programming of contributions in the national currency of the contributing Party concerned. Although not explicitly indicated in decision X/32, a system of contributions that a number of Parties might prefer would be something similar to that used in the replenishment of the Global Environment Facility (GEF), where a fixed exchange rate mechanism is used.

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II. CHARACTERISTICS AND IMPLICATIONS OF THE GEF CONTRIBUTIONS MECHANISM AS COMPARED TO THAT OF THE MULTILATERAL FUND

12. The fundamental difference between the contribution mechanisms of GEF and of the Multilateral Fund is that, while both financial mechanisms approve and implement (through their implementing organizations) projects and programmes committed and accounted for in United States dollars, the agreed contributions to GEF are denominated in special drawing rights (SDRs) or, more significantly, in any convertible currency, in practice the national currency of the contributing Government in question.

13. The latest (second) replenishment of the GEF Trust Fund was agreed upon in February 1998 and payments would normally be in four equal instalments, the first by 30 November 1998 and the last by 30 November 2001. The Trustee of the GEF Trust Fund is authorized to accept contributions for the period from 1 July 1998 to 30 June 2002. This may be considered to be the current four year replenishment period of GEF. The fixed exchange rate applicable for a contribution to GEF which is denominated in a national currency is calculated using average historical exchange rates for an agreed six-month period ending about one year before the first payments are due for the replenishment. The fixed rate applies for the total contribution and therefore the four instalments are equal in the national currency in question, while their United States dollar value depends on the exchange rate applicable at the time of cash payment or encashment of a note contribution. Contributing Participants to GEF whose economies have experienced an inflation rate in excess of 10 per cent for an agreed historical three-year period shall, however, denominate their contributions in SDRs³.

³. The special drawing right (SDR) is an international reserve asset created by the International Monetary Fund (IMF) to supplement existing reserves. It is valued on the basis of a basket of five currencies, those of France (French franc), Germany (deutsche mark), Japan (yen), the United Kingdom (pound sterling) and the United States (United States dollar). The currency amounts are revised every five years, with the next revision due no later than 1 January 2000. The current basket came into effect 1 January 1996, with the following initial weights:

US dollar	39
deutsche mark	21
yen	19
French franc	11
pound sterling	11
Total	100

After the introduction of the Euro on 1 January 1999, the German and the French currencies were substituted by their equivalents in Euros. Consequently, the SDR is currently defined by a basket of four currencies only. The currency amounts for each basket currency are fixed. The exchange rate of the SDR varies daily against the United States dollar and other currencies as a function of the exchange rates of the four basket currencies. The currency amounts, derived from the revision of the basket which came into effect 1 January 1996, and the corresponding United States dollar values and currency weights (in per cent) as at 27 April 1999 were as follows:

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14. It follows from the above that any amounts expressed in United States dollars with respect to GEF, such as the target size of the replenishment, or the resources available for commitment in the GEF Trust Fund at any given time, are only constantly fluctuating estimates which depend on the exchange rates of national currencies and SDRs against the United States dollar.

15. In the Multilateral Fund, the contribution amounts are agreed in United States dollars, which is the accounting currency of the Fund and of its implementing organizations. This allows for, *inter alia*, more exact planning and programming of resources (in United States dollar terms), and for full commitment (in United States dollars) of all available resources at any given time, as the exact amount of actual United States dollars available is always known, even for resources held in the form of promissory notes denominated in currencies other than the United States dollar. Thus the principal effect on the operations of the Multilateral Fund, should a fixed exchange rate mechanism for contributions be adopted, would be the need to put in place provisions and procedures to manage the potential exchange rate risk, which would now be transferred from the contributing Parties to the Fund.

16. For the medium-term planning of the operations of the Fund (e.g., three-year business plans), provision would need to be made for a broader fluctuation of resources actually becoming available as compared to the nominal indicative figures determined by the replenishment decisions at the Eleventh Meeting of the Parties, and/or later assumptions regarding the size of the replenishment for the triennium 2003-2005 and beyond. In calculating the approval (commitment) authority available for the Executive Committee of the Fund at any given time, adequate provision would need to be made for possible future exchange rate losses in respect of resources held in non-United States dollar-denominated promissory notes. In order for these provisions to be quantifiable, one possibility might be to cap the exchange rate risk taken by the Fund to some reasonable figure, with exchange rate losses beyond this still being ultimately borne by the contributing Party concerned.

III. IMPLICATIONS FOR THE MULTILATERAL FUND A MOCK STUDY

17. While it is impossible to forecast exchange rate fluctuations for the next three-year replenishment period of the Fund (2000-2002), some insight into the possible financial implications of a GEF-like fixed exchange rate mechanism may be gained by reviewing the results of a mock desk study conducted at the United Nations Office at Nairobi for a fictitious Fund replenishment period of 1996-1998, otherwise using criteria very similar to that used by the GEF mechanism, as explained in the following paragraphs.

18. The triennium chosen for the study was 1996-1998, these being the most recent full

Currency	Currency amount	US dollar equivalent	%
US dollar	0.5821	0.582100	43.0
Euro	0.3519	0.374175	27.7
yen	27.2000	0.227634	16.8
pound sterling	0.1050	0.169323	12.5
Total		1.353232	100.0

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years, although they do not correspond to the Fund replenishment periods of 1994-1996 or 1997-1999. The latter period is still in progress while the previous one was felt no longer to be current enough to provide the necessary insight for the next replenishment.

19. The list of contributing Parties and the annual contribution levels were taken from the current table of contributions for the year 1999 in order to include actual contribution data which would be as relevant as possible both for the chosen mock triennium 1996-1998, as well as for the next replenishment period, without engaging in any speculation regarding the level of the next replenishment.

20. In line with GEF practice, a six-month period before the first year of the replenishment triennium (1996) was chosen to determine the fixed United States dollar exchange rates to be used for contributing Parties in their national currencies. These fixed rates were calculated as an average of the operational United Nations rates for the period May-October 1995.

21. To be able to estimate the actual United States dollar values of contributions received, it was necessary to make assumptions about when payments would have been received. In the study, it was assumed that all payments of contributions would be due and also paid in equal instalments in June and in December each year. The corresponding United Nations operative exchange rates, which closely follow actual mean rates, were used to calculate actual United States dollar amounts received.

22. Also in line with GEF practice, countries whose national currency values had deteriorated rapidly against the United States dollar were assumed to pay their contributions in United States dollars, while all others were assumed to choose their national currencies as the vehicle of payment, using the fixed rates as determined above. By setting a criteria of 13 per cent or less average annual deterioration of its national currency rate against the United States dollar from 1994 to 1998 (using December United Nations rates), seven Parties were excluded from using their national currencies and assumed to contribute using the United States dollar, in addition to the United States of America.

23. The mock study indicated that the total amounts received, using the fixed exchange rate mechanism, would have been significantly less than the United States dollar amounts originally agreed. This result is without distinction to whether payment was made in cash or in promissory notes. For the total mock replenishment triennium (1996-1998), the loss would have been \$43 million, or 9 per cent of the total assumed agreed contribution of \$474 million, and 13 per cent of the contributions of \$280 million which were assumed to be paid in national currencies, using the agreed fixed exchange rates. Annual losses would have been as follows: 1996 \$7 million (5 per cent), 1997 \$16 million (10 per cent) and 1998 \$19 million (12 per cent). With respect to the national currencies assumed to be used, these figures correspond to a weighted average depreciation against the United States dollar of some 20 per cent over the total period, averaging about 5.2 per cent annually.

24. It could be assumed that approximately \$127 million, about 29 per cent of all contributions received, would have been paid in non-United States dollar-denominated promissory notes. As these would normally be encashed in equal instalments during the three years following deposit, this would introduce a further element of uncertainty, since the final United States dollar amounts received into the Fund would not be known for some years. It could also be expected that, at the end of the three-year replenishment period, some \$84 million would still be held in un-encashed non-United States dollar-denominated notes, corresponding

to about 53 per cent of contributions due for the last year of the replenishment period, or about 18 per cent of the contributions due for the total triennium period.

25. It might be argued that the period chosen for the mock study paints an unduly dismal picture of the potential losses to the Fund, should a fixed rate exchange mechanism be introduced. Indeed, the United States dollar did experience a very significant appreciation against most other major currencies during the time in question, and it could be well expected that the reverse might also occur in the future, resulting in considerable exchange gains to the Fund. At the same time, the often expressed view that in the long term currency fluctuations will tend to cancel each other out cannot be considered very valid for the Multilateral Fund, which has a finite lifetime, with no more than perhaps three additional replenishment periods expected.

26. In this connection, it may be appropriate to recall that the Montreal Protocol (Article 10, paragraph 6) mentions that the contributions to the Fund are based on the United Nations scale of assessments. It would seem implicit that it was the intention of the Parties for one common currency to be used in determining contributions, and within the United Nations system this would normally be the United States dollar.

27. The agreed contributions from the 11 countries using the Euro amounted to approximately 32 per cent of originally agreed contributions, or about \$152 million for the mock replenishment triennium. As a result of exchange rate losses, these contributions declined by about \$18 million or by about 12 per cent from the agreed total amount. This loss of \$18 million constituted about 42 per cent of the total exchange rate loss of \$43 million.

28. The corresponding total exchange depreciation against the United States dollar for the 11 Euro-using Parties for the period ending in December 1998 varied between 3 and 22 per cent, with nine Parties out of eleven experiencing losses against the United States dollar of 17 per cent or more over the total period. The weighted average loss was about 17 per cent, corresponding to an annual average depreciation of about 5 per cent.

29. The analysis of the Euro-using Parties indicates that the fluctuations between the national currencies of the Euro-using countries themselves have been relatively minor in recent years. This is particularly true of those Euro-using countries who are among the major contributors to the Fund, with the possible exception of one country (Italy). It could be tentatively concluded from this observation that it is not likely that the introduction of the Euro would result in significantly more exchange rate volatility between the Euro and the United States dollar than was the case for the combined contribution-weighted national currencies of the Euro-using contributors prior to 1 January 1999, the date when the Euro was introduced.

30. The agreed contributions of Japan amounted to \$85 million for the mock three-year replenishment period, about 18 per cent of all originally agreed contributions. The Japanese yen fell very significantly against the United States dollar already in 1996, as compared to the level prevailing during the period (May-October 1995) used in the mock study to determine the fixed rates for national currencies. Hence the exchange loss encountered for the Japanese contribution was absolutely and relatively even greater than that for the Euro-using countries, \$22 million in total, a drop of 25 per cent from the original agreed contribution. This loss of \$22 million represents 52 per cent of the total exchange loss encountered of \$43 million.

31. The corresponding total exchange depreciation of the yen against the United States

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dollar for the period ending in December 1998 was a considerably high 36 per cent, which works out as a theoretical annual average decline of about 9.2 per cent for this period. Of the total exchange rate loss of \$43 million, \$40 million or about 95 per cent would have been due to the combined reductions in the United States dollar value of the contributions by the 11 Euro-using countries and Japan.

32. Using the United Nations exchange rates for December for the three-year period December 1995-December 1998, it was noted that there were nine contributing Parties whose national currencies had experienced a drop against the United States dollar averaging more than 10 per cent annually and, of these nine Parties, the national currencies of seven had fallen by more than an average of 15 per cent annually during the three-year period reviewed, while the other two had fallen less than 13 per cent. It was also noted that these seven Parties represented about 7 per cent of the agreed contributions to the Fund, while all of the nine Parties mentioned in total represented about 8 per cent of agreed contributions. The majority of Parties included in the group of nine are countries with economies in transition who have historically experienced great difficulties in paying their agreed contributions to the Fund.

33. It was also noted that, during the same three-year period of December 1995 to December 1998, the total depreciation against the United States dollar, over the three-year period, of any individual Party, excluding the nine Parties mentioned in the previous paragraph, did not exceed 26 per cent, and of these, only eight were above 20 per cent, with the remaining 22 being below the 20 per cent figure.

34. The annex to the present report presents the main statistics and figures providing the basis for the calculations used for the mock study and the results indicated above.

IV. POSSIBLE PROCEDURE FOR THE IMPLEMENTATION OF A FIXED EXCHANGE RATE MECHANISM FOR THE REPLENISHMENT OF THE MULTILATERAL FUND FOR THE TRIENNIUM 2000-2002

35. The following paragraphs describe one possible procedure for the implementation of a fixed exchange rate mechanism for the next replenishment of the Fund. It is based on a simplified "GEF-like" concept, which endeavours fully to address the concerns of some of the principal contributing Parties, while simultaneously maintaining the operations of the Fund as efficient, practical and uncomplicated as possible. The potential impact and risks associated with the adoption of such a mechanism are examined simultaneously, as well as the criteria for determining whether a particular currency's fluctuations had been of such a magnitude that a fixed exchange rate mechanism would not be practical. Questions related to the administrative framework are examined in chapter V below.

36. Following the GEF model, contributing countries could be given the option of either agreeing to denominate and pay their contributions in United States dollars, or to denominate and pay their contributions using their national currency, provided that it is accepted that actual payments into the bank account of the Fund would always be in United States dollars even if originating in another currency.

37. For those countries wishing to denominate their contributions in their national currency, fixed rates against the United States dollar would be provided by the Treasurer of the Fund to the Meeting of the Parties deciding on the replenishment of the Fund. These fixed

rates would be calculated using the average monthly United Nations operational rates of exchange for the six-month period immediately preceding the month during which the Meeting of the Parties is held. In 1999, the months in question would be May-October. As United Nations rates are based on average mean rates against the United States dollar, this method would lead to almost the same results as using daily average mean rates for the period, while being less laborious to implement.

38. Contributing Parties having experienced an average annual deterioration of the value of their national currency against the United States dollar of 13 per cent or more, as determined by the Treasurer of the Fund, during the three-year period immediately preceding the Meeting of the Parties (which, for 1999, would be from October 1996 to October 1999) would continue to denominate and pay their contributions in United States dollars. In calculating the average exchange rate fluctuations, the Treasurer would compare the United Nations operational rates of exchange effective for all contributing Parties during the month immediately preceding the Meeting of the Parties (October 1999) with the operational rate of exchange rate effective three years previously (October 1996). It is likely that there would not be more than about 10 Parties falling into this category, representing no more than about 10 per cent of the total agreed contributions to the Fund.

39. For those contributing Parties opting to denominate and pay their contributions in their national currencies, it would be agreed that these contributions so denominated would remain unchanged for the whole replenishment period, provided that the annual fully paid contributions of any such Party would equal at least 80 per cent of the original United States dollar amount agreed for that year, as determined by the Treasurer of the Fund. A contributing Party wishing to denominate its contributions in its national currency would agree to pay to the Fund, in United States dollars, the amount required, as determined by the Treasurer, to bring its annual fully paid contribution up to 80 per cent of the United States dollar amount agreed for that year. Such incremental contributions could be deemed to be due on 31 March the following year.

40. In the case of Parties denominating their contributions in their national currencies and simultaneously opting to pay their contributions in promissory notes, the procedure for determining whether the 80 per cent United States dollar threshold for any annual contribution had been met would be effected (by the Treasurer) on the basis of the actual United States dollar amount received after encashment of all the notes pertaining to the annual contribution in question.

41. Adopting this 20 per cent margin of fluctuation or, in effect, capping the maximum exchange rate risk for the Fund to 20 per cent on non-United States dollar-denominated contributions, would simultaneously address the concerns of some of the major contributing Parties in that, in all likely scenarios, the 20 per cent margin would be adequate to ensure that no additional contributions would be required due to exchange rate fluctuations, while at the same time it would effectively safeguard the Fund from any excessive exchange losses, and allow for exact quantification of the maximum potential losses to the Fund.

42. Assuming that the burden-sharing structure of the Fund would not significantly change for the 2000-2002 replenishment as compared to the previous triennium, the 20 per cent exchange rate fluctuation gap would result in no more than a total additional risk of about 13 per cent in the forecasting of contributions for the whole triennium. For shorter term planning and operations such as approvals of programmes and projects at any given Executive

Committee meeting, a precisely quantifiable 20 per cent provision for exchange rate losses in respect of available resources in the form of non-United States dollar promissory notes would need to be applied, to provide for maximum potential exchange rate risk.

43. To safeguard further the integrity of the Fund by ensuring more timely contribution payments and to discourage any possibility of speculation, it might be advisable for the Parties to consider reviewing the decisions and agreements in force for the dates on which contributions are due and on which promissory notes are to be encashed. One suggestion might be to consider a decision whereby contributions are to be paid on 31 March and 31 October each year in equal instalments, and a further decision on possible sanctions for defaulters, such as additional contributions for potential exchange losses when contributions were not paid on the due dates.

44. In the case of promissory note contributions, it may be beneficial for the operations of the Fund if a specific decision were taken to the effect that encashments of promissory notes are always due in six equal instalments during the three years following the year for which the note contribution is made, say on 31 March and 30 September each year, with no requirement for the Treasurer to show disbursement need. The right of the Treasurer to request accelerated disbursement on demand at any time on an as-needed basis would and should remain in force regardless.

V. ADMINISTRATIVE CONSIDERATIONS

45. It is well within the professional competence and capacity of the United Nations Office at Nairobi as Treasurer of the Fund (on behalf of UNEP) to deal with a contributions mechanism such as that described above, in addition to the duties already performed in exercising this function. No particular new arrangements or framework would be required. Consistent with the existing agreement between the Executive Committee of the Fund and UNEP, neither UNEP nor the United Nations Office at Nairobi would endeavour to seek compensation from the Fund for the costs incurred in carrying out the functions of the Treasurer, despite the increase in the workload that would result from the adoption of a fixed exchange rate mechanism such as that described above.

46. Some concern has, however, been expressed by the Advisory Committee on Administrative and Budgetary Questions (ACABQ) in respect of the cost incurred, as neither UNEP nor the United Nations Office at Nairobi currently receive any payment from the Fund for carrying out the functions of the Treasurer. The United Nations Office at Nairobi is required to report to ACABQ later this year on this matter and, depending on the views of ACABQ, the Office may have subsequently to bring the issue to the notice of the Executive Committee and the Parties.

47. The estimated cost at the United Nations Office at Nairobi and UNEP for managing the functions of the Treasurer is currently in the region of \$150,000 per year. Putting in place a fixed exchange rate mechanism for contributions would again increase the workload somewhat, both in terms of professional and general service staff time, although an exact figure would be difficult to estimate at the current time.

Appendix
